DELAWARE CORPORATE LAW BULLETIN

Chancery Court Applies *M&F* Framework to Transactions in Which Controlling Stockholders Allegedly Received "Unique Benefits"

*Robert S. Reder**
*Elizabeth F. Shore***

** Professor of the Practice of Law at Vanderbilt University Law School. Professor Reder has been serving as a consulting attorney at Milbank, Tweed, Hadley & McCloy LLP in New York City since his retirement as a partner in April 2011.*

*** Vanderbilt University Law School, J.D. Candidate, May 2019.*

The authors express their appreciation to Nicole A. Dressler (Vanderbilt University Law School J.D./M.S., May 2018) and Miron Klimkowski (Vanderbilt University Law School J.D., May 2018) for their work on an earlier draft of this article.

Determines that shift in standard of review from entire fairness to business judgment under M&F not limited to controlling stockholder-led buyouts

INTRODUCTION

Delaware courts have long been suspicious of transactions orchestrated by a controlling stockholder with the controlled corporation. Not only does the "controlling stockholder occup[y] a uniquely advantageous position for extracting differential benefits from the corporation at the expense of minority stockholders," but there also is " 'an obvious fear that even putatively independent directors may owe or feel a more-than-wholesome allegiance to the interests of the controller, rather than to the corporation and its public stockholders.' " *See In re EZCORP Inc. Consulting Agreement Derivative Litigation*, C.A. No. 9962–VCL, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016) ("*EZCORP Litigation*"). Accordingly, when such a transaction is challenged, under the iconic decision of the Delaware Supreme Court in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) ("*Weinberger*"), the controlling stockholder must carry the burden of proving the transaction satisfies the rigorous entire fairness standard of judicial review—that is, the transaction was characterized by both fair dealing and fair price.

The question whether a stockholder controls a corporation is essentially a factual one. According to Vice Chancellor Joseph R. Slights III of the Delaware Court of Chancery (the "*Chancery Court*") in *In re Tesla Motors, Inc. Stockholder Litigation*, C.A. No. 12711-VCS, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018) ("*Tesla*"), a stockholder will be deemed "controlling" if the stockholder either "(1) owns more than 50% of the voting power of a corporation or (2) owns less than 50% of the voting power of the corporation but 'exercises control over the business affairs of the corporation.' " In the case of a minority blockholder, Vice Chancellor Slights noted, "the inquiry is whether [the blockholder] 'exercised actual and domination and control over . . . [the] directors,' " giving her power " 'so potent that independent directors . . . [could not] freely exercise their judgment.' " This is not a simple mathematical exercise: in *Tesla*, Vice Chancellor Slights found a 22.1% stockholder to be in control, whereas less than three weeks earlier, he determined in *In re Rouse Properties, Inc. Fiduciary Litigation*, C.A. No. 12194-VCS, 2018 WL 12226015 (Del. Ch. Mar. 9, 2018) ("*Rouse*"), that a 33.5% stockholder was not in control. (For discussions of *Tesla* and *Rouse*, *see* Robert S. Reder, *Chancery Court Determines That 22.1% Stockholder Controls Corporation, Rendering Corwin Inapplicable*, 72 VAND. L. REV. EN BANC 61 (2018) (analyzing *Tesla*); and Robert S. Reder, *Chancery Court Finds Corwin Applicable to Merger Transaction Negotiated with 33.5% Stockholder*, 72 VAND. L. REV. EN BANC 51 (2018) (analyzing *Rouse*)).

The mere presence of a controlling stockholder is not enough, however, to trigger the entire fairness standard of review of a controlled corporation transaction. Rather, the controlling stockholder must be engaging in a conflicted transaction with the controlled corporation. *See In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, C.A. No. 11202–VCS, 2017 WL 3568089 (Del. Ch. Aug. 18. 2017) ("*Martha Stewart Litigation*"). The archetypal conflicted transaction is a buyout by the controlling stockholder of the shares owned by the corporation's public stockholders (*i.e.*, those not affiliated with the controlling stockholder) in which the controlling stockholder necessarily stands on both sides of the transaction. But Delaware courts also have applied entire fairness in circumstances under which " 'the controller competes with the common stockholders for consideration' " or receives a "unique benefit" not enjoyed by the other stockholders, whether in connection with a sale of the corporation to a third party (*e.g.*, where the controlling stockholder receives greater consideration than the other stockholders or some additional benefit) or otherwise (*e.g.*, where the controlling stockholder obtains some benefit from the controlled corporation not available to the other stockholders, such as a consulting or management services agreement or securities issuances or repurchases). *See IRA Trust FBO Bobbie Ahmed v. Crane*, C.A. No. 12742–CB, 2017 WL 7053964 (Del. Ch. Dec. 11, 2017) ("*IRA Trust Litigation*").

Three recent Chancery Court decisions focus on circumstances in which controlling stockholders, each alleged to have received a "unique benefit" at the expense or to the detriment of public stockholders, sought pleading stage dismissal by urging the court to apply the business judgment rule rather than entire fairness:

1. In *EZCORP Litigation*, Vice Chancellor J. Travis Laster denied a motion to dismiss an action "challeng[ing] the fairness of three advisory services agreements between" an affiliate of a controlling stockholder and the controlled corporation.

2. In *Martha Stewart Litigation*, Vice Chancellor Slights granted a motion to dismiss an action against a controlling stockholder who allegedly received "greater consideration for herself than was paid to the other stockholders" in connection with a third-party buyout.

3. In *IRA Trust Litigation*, Chancellor Andre G. Bouchard granted a motion to dismiss an action challenging a corporate reclassification allegedly structured to benefit a controlling stockholder to the detriment of the other stockholders.

The analyses of the Chancery Court in these cases are instructive for dealmakers and their legal counsel tasked with structuring conflicted transactions involving controlling stockholders to withstand judicial challenge.

I. LEGAL BACKGROUND: THE ENTIRE FAIRNESS STANDARD OF REVIEW

Since *Weinberger*, the Delaware courts have addressed various scenarios in which controlling stockholders have sought to ameliorate the harshness of the entire fairness standard of review, primarily in connection with controlling stockholder-led buyouts. In the eloquent words of Vice Chancellor Slights in the *Martha Stewart Litigation*, as a result of this process:

> [O]ver time, our decisional law has drawn situational "road maps" that guide directors, officers and others involved in the sales process through these scenarios in a manner that will allow them to earn the maximum deference for their decision making that our law allows under the circumstances.

Eleven years after *Weinberger*, the Delaware Supreme Court held in *Kahn v. Lynch*, 638 A.2d 1110 (Del. 1994) ("*Lynch*"), that, in the context of a controlling stockholder-led buyout approved by *either* an independent board committee *or* a vote of a majority of the public stockholders, defendants can shift to plaintiffs the burden of proving the transaction was *not* entirely fair. However, in light of the intensely factual nature of the determination whether a board committee or public stockholder vote satisfied *Lynch*, the Chancery Court was reluctant to grant defendants' motions for early dismissal.

Then, twenty years later, the Delaware Supreme Court took the next step by ruling in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("*M&F*"), that, if a controlling stockholder-led buyout is approved by *both* an independent board committee *and* a majority vote of the public stockholders, the standard of review would shift from entire fairness to the more deferential business judgment presumption. In so ruling, the *M&F* Court explained:

> [W]here the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the stockholder vote, the controlled merger then acquires the shareholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard.

M&F requires satisfaction of six elements (the "*M&F Framework*") for controlling stockholders to obtain the benefit of the shift of the standard of review to business judgment:

> (i) the controller conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisors and to say no definitively; (iv) the special committee meets its duty of care; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

The first element—that the transaction be conditioned from its outset on the dual approval requirements—has become known as the "*Ab Initio Requirement*."

Although *M&F* was decided on a motion for summary judgment and there was some concern, based on language in a footnote, that dismissal at the pleading stage would not be available, the Chancery Court subsequently has granted motions to dismiss on the basis of satisfaction of the *M&F* Framework on four separate occasions:

- *Swomley v. Schlecht*, C.A. No. 9355-VCL, 2015 WL 1186126 (Del. Ch. Nov. 19, 2015), *aff'd*, 128 A.3d 992 (Del. 2015);
- *In re Books-A-Million, Inc. Stockholder Litigation*, C.A. No. 11343-VCL, 2016 WL 5874974 (Del. Ch. Oct. 10, 2016), *aff'd*, 164 A.3d 56 (Del. 2017);
- *In re Synutra International, Inc. Stockholder Litigation*, C.A. No. 2017-0032-JTL, 2018 WL 705702 (Del. Ch. Feb. 2, 2018), *aff'd*, 195 A.3d 754 (Del. 2018); and
- *Olenik v. Lodzinski*, No. 2017-0414-JRS, 2018 WL 3493092 (Del. Ch. July 20, 2018), *aff'd in part*, *rev'd in part*, No. 392, 2018, 2019 WL 1497167 (Del. 2019).

The first three of these decisions have been affirmed by the Delaware Supreme Court, notably without mention of the initial concerns regarding the availability of pleading stage dismissal. (For discussions of these decisions, *see* Robert S. Reder & Lauren Messonnier Meyers, *Delaware Supreme Court Affirms Pleading-Stage Dismissal of Control Stockholder Buyout Litigation*, 69 VAND. L. REV. EN BANC 17 (2016) (analyzing *Swomley*); Robert S. Reder, *Delaware Court Grants Pleading-Stage Dismissal of Litigation Challenging Control Stockholder-Led Buyout*, 70 VAND. L. REV. EN BANC 217 (2017) (analyzing *Books-A-Million*); and Robert S. Reder, *Chancery Court Again Grants Early Dismissal of Litigation Challenging Control Stockholder-Led Buyout*, 72 VAND. L. REV. EN BANC 11 (2018) (analyzing *Syntura*).

Two (of the several) questions remaining after *M&F* was whether the entire fairness standard of review is applicable to conflicted transactions *not* involving a controlling stockholder-led buyout and, if so, whether the *M&F* Framework is available to shift the standard of review to business judgment. These questions were addressed by the Chancery Court in the *EZCORP Litigation*, the *Martha Stewart Litigation*, and the *IRA Trust Litigation*.

II. FACTUAL BACKGROUND: EZCORP, MARTHA STEWART, AND IRA TRUST LITIGATION

A. EZCORP Litigation

EZCORP, Inc. ("EZCORP") "provides instant cash solutions through a variety of products and services, including pawn loans, other short-term consumer loans, and purchase of customer merchandise." EZCORP's outstanding stock consisted of two classes identical in all respects except for voting rights: publicly-traded Class A Non-Voting Common Stock and Class B Voting Common Stock wholly owned (through affiliated entities) by Phillip Ean Cohen ("*Cohen*"). As a result, Cohen, who owned only 5.5% of the equity, controlled 100% of EZCORP's voting power.

Over the years, EZCORP entered into advisory service agreements with multiple Cohen affiliates, including Madison Park LLC ("*Madison Park*"). Generally speaking, the advisory service agreements with Madison Park (the "*Challenged Agreements*") were renewed annually with the consent of the Audit Committee of the board of directors of EZCORP (the "*Audit Committee*"), which consisted entirely of independent directors. The renewals covering the 2012, 2013, and 2014 fiscal years provided fees to Madison Park representing approximately 5% of EZCORP's annual net income in 2012 and 2013 and 21% in 2014.

On May 20, 2014, the Audit Committee terminated the most recent of the Challenged Agreements due to "concerns about the fairness of the relationship." Thereafter, stockholder-plaintiff Lawrence Treppel requested examination of the Challenged Agreements and related documents pursuant to 8 Del. C. § 220. Not only did EZCORP refuse this request but, on July 18, Cohen "clean[ed] house" by removing two of the Audit Committee members and the CEO from the board.

Treppel commenced litigation in Chancery Court on July 28 against Cohen and his affiliates as well as the other members of the EZCORP board, claiming the Challenged Agreements "were not legitimate contracts for services but rather a means by which Cohen extracted a non-ratable cash return from EZCORP." According to Treppel's complaint, "Madison Park was a small firm with limited resources" and EZCORP was Madison Park's "only publicly traded client in the United States." Further, EZCORP was led by experienced and highly compensated corporate officers whose job descriptions included many of the services described in the Challenged Agreements, resulting in Madison Park providing advisory services " 'substantially, if not entirely duplicative' " to those provided by the senior management. Despite EZCORP's decline in performance over this period, Madison Park's fees remained unchanged.

B. Martha Stewart Litigation

Martha Stewart Living Omnimedia, Inc. ("*MSLO*") "conducted a media and merchandising business, creating original how-to content and related products for homemakers and other consumers." Martha Stewart ("*Stewart*"), the "founder and namesake of MSLO," was MSLO's controlling stockholder with 88.8% voting power through her exclusive ownership of the ten-vote-per-share Class B common stock and served on its board of directors. Public stockholders owned one-vote-per-share Class A common stock. In her capacity as the namesake and founder of MSLO, Stewart (or related entities) entered into three contracts with MSLO: an employment agreement, an intellectual property agreement, and an intangible asset license agreement.

On April 10, 2015, MSLO re-initiated conversations with Sequential Brands Group, Inc. ("*Sequential*") concerning Sequential's interest in purchasing MSLO. On May 12, at Sequential's request, a special committee of independent directors appointed by the MSLO board (the "*Special Committee*") "authorized Stewart to negotiate her post-closing arrangements at the same time the Special Committee negotiated the merger terms with Sequential, subject to the Special Committee's right to review those arrangements." Understandably, "Sequential did not want to commit substantial resources to merger negotiations without at least simultaneously determining whether they could reach agreements with Stewart—the face of the Company."

On June 5, Sequential made a proposal with two alternatives: *either* a price of $6.15 per share accompanied by a "no-shop" provision *or* a price of $6.00 per share accompanied by a post-signing "go-shop" provision. Both alternatives represented a premium over the trading price MSLO stock. Sequential's offer also included a 3.75% termination fee and "unlimited matching rights for Sequential, information rights and a right to expense reimbursement of $2.5 million" if the transaction was not approved by MSLO stockholders. The Special Committee requested, but was denied, an increase in Sequential's bid to $6.65 per share.

On June 20, "the Special Committee was informed . . . that Stewart had negotiated an agreement whereby Sequential would reimburse Stewart for up to $4 million of the fees she incurred in negotiating her post-closing arrangements . . . ." Sequential also agreed, post-closing, that Stewart would maintain substantially similar contractual arrangements with Sequential as she had with MSLO pre-closing (collectively, the "*Side Deals*"). In response, the Special Committee requested and received Sequential's permission "to engage in a thirty-day post-signing go-shop in lieu of a price increase." Further, MSLO stockholders would be given the right to choose to receive the $6.15 merger consideration either in cash or Sequential stock, and the transaction would be conditioned on approval by holders of a majority of the outstanding MSLO shares not owned by Stewart.

After receiving a fairness opinion from its financial advisor, the Special Committee unanimously voted to recommend the transaction to the MSLO board, which accepted the recommendation. At the subsequent MSLO stockholders' meeting, "an overwhelming majority of the minority stockholders (99%) vot[ed] to approve the deal." The transaction closed on December 4.

Former MSLO stockholders brought suit in Chancery Court, claiming Stewart "leveraged her position as controller to secure greater consideration for herself than was paid to the other stockholders." Because Stewart received the same price per share in the transaction as the other stockholders, plaintiffs' claims against Stewart focused on the Side Deals.

C. IRA Trust Litigation

NRG Energy, Inc. ("*NRG*") "produces, sells, and delivers energy, energy products, and energy services in the United States." In 2012, NRG incorporated NRG Yield, Inc. ("*Yield*") "as a dividend growth-oriented company to serve as the primary vehicle through which NRG would own, operate, and acquire energy generation and infrastructure assets." Pursuant to a Management Services Agreement (the "*MSA*"), NRG "provide[s] services to Yield, including carrying out . . . management, accounting, banking, treasury, administrative, liaison, representative, regulatory, and reporting functions and obligations." The MSA also allows NRG "to make recommendations with respect to the payment of dividends and the exercise of any voting rights to which Yield is entitled with respect to its subsidiaries." The prospectus for Yield's initial public offering ("*IPO*") stated "NRG will be [Yield's] controlling stockholder and will exercise substantial influence over Yield and [Yield is] highly dependent on NRG."

Yield's board of directors consisted of seven individuals, four of whom were members of management appointed by NRG and three of whom where independent and served on a conflicts committee (the "*Conflicts Committee*"). The Conflicts Committee's mission was "to review and approve proposed conflicted transactions between Yield and NRG."

Upon its IPO, Yield had two classes of stock, Class A and Class B, each of which entitled the holder to one vote. Class A stock was traded publicly while Class B stock was wholly-owned by NRG and comprised "65% of Yield's voting power." As part of its business model, "Yield . . . depended on NRG as a source for its income-producing assets" and was granted by NRG a contractual "right of first offer on certain NRG assets" (the "*ROFO Agreement*"). To finance asset purchases post-IPO, Yield issued additional Class A shares, thereby diluting NRG's ownership and control position. By fall 2014, "NRG's voting power fell from approximately 65% to approximately 55% due to equity issuances."

In response, NRG "presented to the [Yield] Board several alternatives that would allow Yield to continue raising capital for acquisitions while preserving NRG's control." NRG's proposals were specifically "conditioned on obtaining the approval of . . . a 'majority of the minority' of the outstanding shares of Class A stock not affiliated with NRG." Likewise, the Conflicts Committee was authorized by the Yield board to "evaluate and negotiate the proposed reclassification with NRG."

After several rounds of negotiations, the Conflicts Committee and NRG agreed on a reclassification (the "*Reclassification*") providing that:

> Yield would establish two new classes of common stock (Class C and Class D) and distribute shares of Class C and Class D stock to holders of then outstanding Class A and Class B shares, respectively, through a stock split. Yield and NRG also would enter into [an] Amended ROFO Agreement, making additional assets potentially available to Yield.

The new shares of Class C and D stock each "would entitle holders to 1/100 of one vote per share." In seeking stockholder approval of the Reclassification, the Yield board noted in its proxy materials the "rationale for approving the Reclassification included the Conflict Committee's belief that the transaction would provide a means to continue raising capital through future equity issuances as well as to maintain Yield's relationship with NRG." The proxy materials also highlighted "that the Reclassification could prolong the period over which NRG could exercise a controlling influence over Yield, but that the [Yield board] believed that NRG's controlling influence would provide significant benefits."

The holders of a majority of the Class A stock voted in favor of the Reclassification, which became effective on May 14, 2015. In an action challenging the Reclassification filed in Chancery Court, plaintiffs asserted, among other things, that "NRG breached its fiduciary duty as the controlling stockholder of Yield by causing Yield to undertake the Reclassification."

III. THE CHANCERY COURTS' ANALYSES

The commonality of issues addressed by the Chancery Court in the *EZCORP Litigation*, the *Martha Stewart Litigation*, and the *IRA Trust Litigation* is striking. In fact, the decisions build on each other. Each decision is a ruling on a preliminary motion to dismiss brought by the controlling stockholder and, of necessity in breach of fiduciary duty cases, the judicial focus is on application of the appropriate standard of review. As such, these opinions, taken together, provide important insight into how Delaware courts will apply the *M&F* Framework to alleged conflicted transactions involving controlling stockholders outside the context of controlling stockholder-led buyouts.

A. *EZCORP Litigation – Entire Fairness Governs any Transaction in Which a Controlling Stockholder Receives a "Non-ratable"*

Benefit

Vice Chancellor Laster began his analysis by noting that while "[t]he entire fairness framework clearly governs squeeze-out mergers, . . . Delaware courts also have applied it more broadly to transactions in which a controller extracts a non-ratable benefit." The Vice Chancellor then cited three decisions in which "Delaware courts have expressly rejected the contention that the entire fairness framework only applies to squeeze-out mergers," as well as fifteen more in which "Delaware courts have applied the entire fairness framework to a variety of transactions in which controlling stockholders have received non-ratable benefits, implicitly rejecting the view that the framework only applies to squeeze-outs."

Next, Vice Chancellor Laster discussed in some detail "three rulings that did not apply the entire fairness framework to transactions through which a controller extracted a non-ratable benefit," but concluded "that the three cases are not persuasive" and, therefore, "the weight of authority calls for applying the entire fairness framework more broadly." The Vice Chancellor also concluded that a potentially limiting decision in the "demand futility" context was inapposite, opining he would not use that decision "as a springboard for cutting back on [subsequent] case law governing entire fairness transactions." On this basis, he determined "the operative standard of review for the Challenged Agreements is entire fairness."

At this point, Vice Chancellor Laster turned to the question whether the process employed by the Audit Committee to approve the Challenged Agreements warranted a "shifting of the burden of proof." Because the Challenged Agreements had not been submitted for approval by a majority-of-the-minority stockholder vote, the *M&F* Framework was not available for a shift to business judgment. However, the Vice Chancellor noted, "the involvement of the Audit Committee operat[ed] potentially as a basis for shifting the burden of proof to the plaintiff." While a different conclusion may have been reached "at a later stage of the case," "a[t] the pleading stage, the involvement of the Audit Committee does not defeat the breach of fiduciary claim" inasmuch as "[d]etermining whether a committee of directors is effective is a 'fact-intensive inquiry.' " Accordingly, " 'a motion to dismiss is not the proper vehicle for deciding whether the burden of proof under entire fairness should be shifted.' "

B. Martha Stewart Litigation—M&F Framework Available to Shift Standard of Review to Business Judgment in Connection *with Third Party Buyout*

In seeking application of the business judgment rule as the standard of review, Stewart argued that, *first*, Sequential's buyout of MSLO "was an arm's-length transaction with a third party" that "gave her nothing more than she was already receiving from MSLO" and, *second*, even if it were considered a conflicted transaction, the process leading to approval of the buyout satisfied the *M&F* Framework. Plaintiffs countered that entire fairness was applicable because: (i) Stewart, as the controlling stockholder, "diverted consideration to herself at the expense of the minority stockholders in the form of side deals dressed up as an employment agreement and various intellectual property-related agreements," and (ii) the process employed to approve the transaction failed to satisfy the *M&F* Framework due to (x) a lack of independence on the part of the Special Committee, (y) the untimeliness of Sequential's commitment to condition the transaction on approval by holders of a majority of the outstanding MSLO shares not owned by Stewart, and (z) the adequacy of the disclosures made to MSLO stockholders in connection with their approval of the transaction.

In granting Stewart's motion to dismiss, Vice Chancellor Slights determined business judgment, rather than entire fairness, was the applicable standard of review because:

- *No Conflicted Transaction*. Plaintiff's claim that Stewart engaged in a conflicted transaction was based on a "false narrative": (i) Sequential did not lower its offer after completing negotiations with Stewart concerning the Side Deals but, to the contrary, "*increased* its offer after those negotiations were, in essence, concluded," and (ii) plaintiffs "failed to distinguish the 'new' side deals from the 'old' side deals in any meaningful way that would support the inference that Stewart was extracting consideration from Sequential that otherwise would have gone to the MSLO shareholders."

- *M&F Framework Applicable*. Stewart argued that strict adherence to the six elements of the *M&F* Framework was not required in the context of the sale of MSLO to Sequential because "a two-sided controller transaction is inherently more suspect than a sale to a third party.' " Vice Chancellor Slights disagreed, writing: "I am satisfied that strict compliance with the transactional roadmap laid out in [*M&F*] is required for the controlling stockholder to earn pleadings-stage business judgment deference when it is well-pled that the controller, as seller, engaged in a conflicted transaction by wrongfully diverting to herself merger consideration that otherwise would have been paid to all stockholders."

- *Application of the Ab Initio Requirement in a Third-Party Buyout*. Plaintiffs' claimed Sequential's agreement to a majority-of-the-minority vote came too late in the process to satisfy the *Ab Initio* Requirement. The Vice Chancellor disagreed, noting that the ability of the controlling stockholder to condition the transaction on the dual approvals of the first element of the *M&F* Framework "in its initial offer to the board of the target" is not present "where an unaffiliated third party initiates the process with its offer. . . ." Therefore, in the case of third-party buyouts, it is sufficient for purposes of the *Ab Initio* Requirement that "the third party and the target have agreed to both procedural protections before [the controlling stockholder] begins to negotiate separately with the third party for disparate or non-ratable consideration. That is when the potential conflict with the minority surfaces."

- *Was the M&F Framework Satisfied*? In Vice Chancellor Slights' opinion, had he found Stewart had engaged in a conflicted transaction, the MSLO board "followed the *M&F Worldwide* road map with precision," justifying a shift in the standard of review to business judgment. With respect to plaintiff's two contentions concerning non-satisfaction of the *M&F* Framework, the Vice Chancellor found (i) plaintiffs' pleadings were not sufficient to call into question the effectiveness of the Special Committee, (ii) the *Ab Initio* Requirement was satisfied before Stewart and Sequential began their separate negotiations, and (iii) there were no material non-disclosures in the information given to MSLO stockholders to solicit their votes.

C. IRA Trust Litigation – M&F Framework Available Outside of "Controlled Merger Scenario"

As in the *Martha Stewart Litigation*, Chancellor Bouchard's analysis of defendants' motion to dismiss centered on whether (i) NRG, as the controlling stockholder, had engaged in a conflicted transaction with Yield warranting application of entire fairness, (ii) the *M&F* Framework was available under the circumstances to shift the standard of review to business judgment, and (iii) the *M&F* Framework was indeed satisfied. The Chancellor, in granting the motion to dismiss, answered all three questions in the affirmative:

- *Reclassification as a Conflicted Transaction*. The Chancellor rejected NRG's attempt to analogize the Reclassification to *pro rata* dividends as to which all stockholders receive equal treatment, noting "plaintiff has pled non-conclusory facts to support the inference that . . . NRG . . . was on the cusp of losing its control position in Yield when it undertook the Reclassification, which admittedly was done to perpetuate that control." Therefore, at least for pleading stage purposes, the Chancellor found that the Reclassification produced a "unique benefit" for NRG "warrant[ing] review of the Reclassification as a conflicted controller transaction that presumptively would be subject to entire fairness review."

- *MFW Framework Applies to the Reclassification*. Chancellor Bouchard noted that both the *EZCORP Litigation* and the *Martha Stewart Litigation* "endorsed using the [*M&F*] framework outside of the context of a squeeze-out merger." The Chancellor expressed his agreement with this position, holding "that the [*M&F*] framework should apply to the Reclassification, as I can see no principled basis on which to conclude that the dual protections in the [*M&F*] framework should apply to squeeze-out mergers but not to other forms of controller transactions." In so ruling, the Chancellor rejected plaintiff's contention that *M&F* should not apply outside the "controlled merger scenario" due to other "protections" provided in that scenario, including appraisal rights and the obtaining of a fairness opinion. He dispatched the former argument as a "*non sequitur*" and the latter as "equally unconvincing."

- *Was the M&F Framework Satisfied*? According to Chancellor Bouchard, plaintiff's "only serious challenge" to application of *M&F* focused on the fifth element: whether the majority-of-the-minority vote was "informed." After dissecting five separate alleged deficiencies in the disclosures made to Yield stockholders to inform their vote, the Chancellor found that this element of the M&F Framework had indeed been satisfied, thereby shifting the standard of review to business judgment. In this connection, he noted that while certain disclosures may not have followed so-called best practices, "[b]est practice . . . does not necessarily equate to materiality."

CONCLUSION

Delaware courts are working actively to establish the boundaries of the *M&F* Framework. The decisions in the *EZCORP Litigation*, the *Martha Stewart Litigation*, and the *IRA Trust Litigation* demonstrate that the Chancery Court intends that all conflicted transactions in which controlling stockholders receive a "non-ratable benefit" (i.e., not just controlling stockholder-led buyouts) will be subject to the same analysis in terms of the applicable judicial standard of review. Thus, while these conflicted transactions—such as third party buyouts in which a controlling stockholders receive favored treatment; "security issuances, purchases, and repurchases; asset leases and acquisitions; compensation arrangements, consulting agreements, and service agreements; . . . and recapitalizations"—will be subject initially to entire fairness review. If, however, they are approved and otherwise effected in a manner that satisfies the *M&F* Framework, the controlling stockholders will be entitled to a shift in the standard of review to business judgment and an early dismissal. Further, the *Ab Initio* Requirement relating to the dual approval requirement of the first element of the *M&F* Framework will be satisfied if these protections are committed to *before* negotiations begin over the controlling stockholder arrangements.